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SUBJECT: CHILE: COPPER INDUSTRY REVIEW

11. (U) Summary: Copper represents nearly half the value of Chile's exports and remains a key component of Chile's economy. Record copper prices explain in part Chile's real GDP growth rates of over six percent in 2004 and 2005. Chile currently produces 37 percent of the world's copper, more than the next six top producers combined. China is its largest consumer, purchasing about 20 percent of Chile's annual copper production. A Chinese company, MinMetals, and the state-owned Chilean company, Codelco, signed in February 2005 a joint venture to invest USD 2 billion in Chilean copper production. Codelco is responsible for about 40 percent of Chile's copper production, with the remainder privately produced. The new Bachelet administration is expected to fund some of its social programs with copper revenues. End summary.

Copper's Place in the Chilean Economy

12. (U) In dollar terms, copper exports represented 43.8 percent of the total value of Chilean exports in 2005, or just over 15 percent of Chile's total GDP. Copper is by far Chile's most important product, and it is important to GOC financing and long-term planning. The GOC does not count on the record copper prices of recent years to remain a long-term trend; as of mid-April, the price of a pound of copper stood at USD 2.70. For its budgeting purposes, it counts the price of copper at under a dollar per pound. At the same time, GOC officials have indicated that the first social programs under the Bachelet government -- free health care for those over 60, expanding the coverage of the national health care plan, and increasing the minimum guaranteed pension -- will be financed at least in part by the government coffers filled with copper profits.

13. (U) As a further reflection of the key role copper plays in determining Chile's real GDP growth rate, the Chilean Central Bank closely tracks the trends in long-term copper prices and uses copper statistics to predict potential real GDP growth. While Chile's overall economy is doing well, record copper prices have pushed real GDP growth to 6.1 percent in 2004 and 6.3 percent in 2005.

Chile as a Global Supplier

14. (U) Copper is the dominant sector in Chile's trade relationship with the rest of the world. Despite the diversification of exports and the growth of Chile's overall economy, copper remains king. After the end of the Pinochet

military government in 1990, Chile attracted large inflows of foreign capital, particularly direct investment in mining. The rush of private investment boosted Chile's copper output from 18 percent of the world's supply in 1990, to 37 percent by 2004.

¶5. (U) In the last two years, a range of factors -- including the GOC's limits on production -- have driven copper prices far above USD 2 per pound and kept them there. Copper cost 70 cents per pound in 2001, and was priced at USD 2.70 per pound as of mid-April 2006. In 2005, Chile produced 5.1 million metric tons of copper or approximately 37 percent of world production, more than the next six copper producing countries combined. While Chilean annual production has not increased in recent years, remaining at around 5.1 million metric tons, the northern Andean region of Chile contains 40 percent of the world's proven copper reserves.

Commercial Ties with China

¶6. (SBU) In 2004, China's share of world copper usage was 20.4 percent, making it the world's single largest copper consumer. By comparison, the United States was second at 14.5 percent. China currently consumes about 20 percent of Chile's annual copper production. A Chinese company, MinMetals, in February 2006 signed a deal with Codelco for a USD 2 billion dollar joint venture. While the joint venture is not directly related to the free trade agreement Chile and China signed in November 2005, one of Chile's chief trade agreement negotiators told econoff that securing long-term access to Chilean copper was clearly a key motivating factor for China in seeking the trade deal.

Role of State-Owned Codelco

¶7. (U) State-owned Codelco alone is responsible for 40-45 percent of Chile's copper production and 15-17 percent of total world production. The GOC's management of Codelco has seen its share of controversy, with recent scandals renewing the debate over privatization. Given Codelco's clear role in providing long-term revenue for the GOC, there is little support for such a move and no serious plans for selling Codelco. Even the Chilean military has a vested interest in Codelco remaining a state-owned entity, as 10 percent of all Codelco revenues go to military procurement by law. In terms of its equity value rather than income stream, in 2006, Goldman Sachs estimated Codelco's financial value at USD 26 billion.

¶8. (U) President Bachelet named Jose Pablo Arellano as CEO of Codelco in March 2006. Arellano has a Ph.D. in Economics from Harvard and was previously Minister of Education and budget director for the Ministry of Finance. In making Arellano's appointment, Bachelet reiterated her campaign pledge to use copper earnings to fund programs to help the three million Chileans who live below the poverty line. With copper hitting new all-time record prices nearly every week, this will be a relatively easy promise to keep for now.

¶9. (U) Comment: The jump in copper prices since 2003 has given the GOC some unexpected income. This will allow President Bachelet room to inaugurate new as well as expand existing social plans. Record copper prices have also been the key to allowing Chile to record GDP growth higher than it would have otherwise. Without the high copper prices, the Chilean economy would still have recorded good GDP growth in recent years as many of the fundamentals such as declining unemployment and low inflation are not tied to copper. Chile has succeeded at developing a range of non-traditional export sectors in order to diversify its trade profile. But world demand for copper means copper will likely continue to play a dominant role in Chile's trade with the world and in defining the country's overall real GDP growth.

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